

Georgia State University

## ScholarWorks @ Georgia State University

---

CSLF Working Papers

Center for State and Local Finance

---

3-1-2019

### New Normal? The Declining Relative Importance of State Taxes

David Sjoquist

*Georgia State University*

Follow this and additional works at: [https://scholarworks.gsu.edu/ays\\_cslf\\_workingpapers](https://scholarworks.gsu.edu/ays_cslf_workingpapers)

---

#### Recommended Citation

Sjoquist, David, "New Normal? The Declining Relative Importance of State Taxes" (2019). *CSLF Working Papers*. 11.

[https://scholarworks.gsu.edu/ays\\_cslf\\_workingpapers/11](https://scholarworks.gsu.edu/ays_cslf_workingpapers/11)

This Article is brought to you for free and open access by the Center for State and Local Finance at ScholarWorks @ Georgia State University. It has been accepted for inclusion in CSLF Working Papers by an authorized administrator of ScholarWorks @ Georgia State University. For more information, please contact [scholarworks@gsu.edu](mailto:scholarworks@gsu.edu).

MARCH 2019

---



THE  
CENTER  
FOR  
STATE  
AND  
LOCAL  
FINANCE

# New Normal? The Declining Relative Importance of State Taxes

David L. Sjoquist

Working Paper 19-03



---

# The Center for State and Local Finance

WORKING PAPER 19-03

## New Normal? The Declining Relative Importance of State Taxes

DAVID L. SJOQUIST

March

2019

---

Note: This paper was previously published by *State Tax Notes* in September 2018.

The Center for State and Local Finance  
Andrew Young School of Policy Studies  
Georgia State University  
Atlanta, Georgia 30303  
United States of America

Phone: (404) 413-0137  
Fax: (404) 413-0248  
Email: [paulbenson@gsu.edu](mailto:paulbenson@gsu.edu)  
Website: [cslf.gsu.edu](http://cslf.gsu.edu)

Copyright 2019, the Andrew Young School of Policy Studies, Georgia State University. No part of the material protected by this copyright notice may be reproduced or utilized in any form or by any means without prior written permission from the copyright owner.

---

# The Center for State and Local Finance

## Andrew Young School of Policy Studies

The Center for State and Local Finance's (CSLF) mission is to develop the people and ideas for next generation public finance by bringing together the Andrew Young School's nationally ranked faculty and the broader public finance community. CSLF conducts innovative, nonpartisan research on tax policy and reform, budget and financial management, education finance, and economic development and urban policy. Additionally, it provides premier executive education in public finance for state and local finance officials and works with local and state partners on technical assistance projects on fiscal and economic policy.

CSLF Reports, Policy Briefs, and other publications maintain a position of neutrality on public policy issues in order to safeguard the academic freedom of the authors. Thus, interpretations or conclusions in CSLF publications should be understood to be solely those of the author(s).

For more information on the Center for State and Local Finance, visit our website at [cslf.gsu.edu](http://cslf.gsu.edu).

---

## Table of Contents

Introduction	1
Total State Tax Revenue	2
Personal Income Tax	3
Sales Tax	6
Corporate Income Tax	8
Fuel Tax	10
Summary	11
Appendix	12
About the Author	16

## Introduction

The Great Recession's substantial effect on state revenue has been well documented.<sup>1</sup> For example, real state tax revenue in fiscal 2010 was only 84.5 percent of its fiscal 2007 level. Total state tax revenue as a share of personal income fell from 6.36 percent of income in 2007 to 5.71 percent in 2010 — a decrease of 10.2 percent. Not until fiscal 2016 did real state tax revenue reach its fiscal 2007 level, and unlike other recessions, state tax revenue as a percentage of income has yet to return to its pre-recession level. Although the United States has seen nine years of economic expansion since the Great Recession, states continue to face serious fiscal problems.<sup>2</sup>

Figure 1 (see Appendix), which plots state tax revenue as a percentage of personal income, shows the effect of the Great Recession and the subsequent recovery on state tax revenue, controlling for the level of economic growth.<sup>3</sup> The diamonds in Figure 1 are fiscal years associated with recessions. During the Great Recession, state tax revenue decreased: By 2017, state tax revenue as a percentage of income was just 5.79 percent, which is 9 percent less than in 2007 and 4.66 percent less than in 2013.

An obvious question is, why has state tax revenue as a percentage of income not returned to its pre-Great Recession level? There are two potential reasons: Either economic growth has not increased the tax base sufficiently or policymakers have not raised taxes sufficiently. This paper explores this question. While many explanations are possible, I suggest that reduced state taxes as a percentage of income post-Great Recession is the result of policy decisions to reduce state taxes as a share of income. In other words, the post-2008 period could be a “new normal.”

The lower value of state taxes as a percentage of income should be of concern if this decrease is caused by economic or structural factors. That case implies that a higher level of taxes as a percentage of income is desired, and thus it would be important to make appropriate changes. However, if the lower value is the result of policy decisions, then presumably the lower value is preferred by decision-makers.

In this paper, I first discuss the trend in total state taxes as a percentage of income. I then discuss four specific taxes to provide a framework for discussing policy decisions.

<sup>1</sup> See Tracy Gordon, “State and Local Budgets and the Great Recession,” Russell Sage Foundation and Stanford Center on Poverty and Inequality (Dec. 2012).

<sup>2</sup> Donald J. Boyd and Lucy Dadayan document this as of 2015. “The Economy Recovers While State Finances Lag,” Rockefeller Institute of Government (June 2015). See also Aidan Davis, “Trends We’re Watching in 2018, Part 2: State Revenue Shortfalls and the Impact on Education and Other Services,” Institute on Taxation and Economic Policy (Mar. 12, 2018); National Conference of State Legislatures, “State Partisan Composition” (Apr. 11, 2018).

<sup>3</sup> State tax revenue data are from the U.S. Census Bureau. Personal income data come from the U.S. Bureau of Economic Analysis and are defined as annual personal income as of the second quarter, which is the last quarter of the fiscal year for all but four states. The Census Bureau does not treat the District of Columbia as a state; thus, this analysis considers only the 50 states.

## Total State Tax Revenue

Between 1950 and 1972, total state taxes as a percentage of personal income rose steadily from 3.49 percent to 6.01 percent — a 2.52 percentage point increase. Over the next 23 years, the growth slowed substantially, increasing from 6.01 percent in 1972 to 6.42 percent in 1995 (see Figure 1) — only a 0.41 percentage point increase. Since 1995, total state taxes as a percentage of personal income has declined, falling to 5.79 percent as of 2017.

Between 1972 and 2008, state taxes as a percentage of personal income ranged between 6 and 6.4 percent, averaging 6.16 percent. The exceptions were the six years associated with the two recessionary periods in the early 1980s and early 2000s. In contrast, between 2009 and 2017 state tax revenue as a percentage of personal income, with one exception, ranged between 5.71 and 5.93 percent, averaging 5.86 percent. The exception was 2013, when the percentage increased to 6.06 percent largely because of tax increases of \$5.3 billion in California and \$1.6 billion in New York.<sup>4</sup> Clearly the post-2008 level of state tax revenue as a percentage of income is significantly lower than from 1972 to 2008.

This reduction in taxes as a percentage of income could have several explanations. First, states may have used increases in intergovernmental revenue or nontax own-source revenue to reduce taxes. However, that does not appear to be the case. General revenue (the sum of taxes, intergovernmental grants, and charges and fees) as a percentage of income peaked in 2010. It declined thereafter, following a pattern similar to that shown in Figure 1. Intergovernmental revenues as a percentage of income increased significantly after 2008 thanks to the American Recovery and Reinvestment Act. It topped out in 2010, then declined to its 2004 level. Charges and fee revenue as a percentage of income peaked in 2009 and has been on a downward trend ever since. Thus, the lower level of taxes as a percentage of income since 2009 cannot be explained by offsetting increases in intergovernmental revenue and nontax own-source revenue.

A second possible explanation is legislative restrictions on increases in state tax revenue. Several states require a legislative supermajority or state referendum to pass tax increases. Before 2008, 16 states had such requirements.<sup>5</sup> Wisconsin is the only state to adopt such a restriction after 2008, which it did in 2011. Despite these restrictions, however, states increased taxes by a reported \$33.4 billion during the Great Recession.<sup>6</sup> Also, these 17 states are not solely responsible for the overall reduction in tax revenue as a percentage of income, because all but eight of the 50 states experienced a reduction in this metric. Thus, it does not appear that state tax limitations are the cause of the post-2008 decrease in state taxes as a percentage of income.

<sup>4</sup> National Association of State Budget Officers, “The Fiscal Survey of the States” (Fall 2012)

<sup>5</sup> See Allison Hiltz and Luke Martel, “Supermajority Vote Requirements to Pass the Budget,” NCSL (Jan. 2015). In Michigan the requirement only applies to the state property tax, and in Florida it only applies to the corporate income tax.

<sup>6</sup> Boyd and Dadayan, *supra* note 2.



Third, changes in taxes are ultimately the result of political decisions. Thus, the change in the political makeup of state governments since 2008 is another possible explanation. In 2008 Republicans controlled 14 legislatures, 22 governorships, and both houses and the governorship in nine states. In 2017, Republicans controlled 32 legislatures, 33 governorships, and both houses and the governorship in 24 states.<sup>7</sup> Empirical evidence shows that Republican governments are associated with smaller state budgets.<sup>8</sup> Thus, increased Republican control of state governments could explain the post-2008 decrease in taxes as a percentage of income.

State tax revenue as a percentage of income has been below the 1972-2008 average for nine years and has been decreasing for the past four years. Moreover, the post-2008 reduction in tax revenue has been widespread across states and across taxes. This suggests a more permanent condition rather than a temporary phenomenon. All but eight states experienced a decrease in tax revenue as a percentage of income. Tax revenue as a percentage of income has also declined for most taxes. Of the 28 tax categories used by the U.S. Census Bureau, tax revenue as a percentage of income fell for all but a few minor taxes. Tax revenue as a percentage of income increased for tax categories totaling just 9.6 percent of fiscal 2008 tax revenue.

These factors suggest that this lower value of state tax revenue as a percentage of income is a policy choice — that is, a new normal. This is consistent with the argument that state and local governments used the Great Recession as cover to make changes in government operations. If the lower value of taxes as a percentage of income is the result of conscious decisions, then we should explore tax policy decisions that states have made. Thus, to gain a better understanding of the reasons for the decrease in total taxes as a percentage of income, I explore trends for four taxes. Of the decrease in state taxes as a percentage of personal income between 2007 and 2017, 76.9 percent is accounted for by changes in personal income taxes, general sales taxes, motor fuel taxes, and corporate income taxes. In 2017 these four taxes accounted for 83.2 percent of total state tax revenue. Thus, I focus on changes in these four taxes to help explain why state taxes as a percentage of personal income has fallen since 2008.

## Personal Income Tax

In fiscal 2017, personal income taxes accounted for the largest share of total state taxes, 41.9 percent. Figure 2 shows personal income tax revenue as a percentage of personal income from 1972 to 2017.<sup>9</sup> During this time, the percentage increased steadily from 1.51 percent to 2.85 percent. Since 2001, however, the pattern more resembles a roller coaster because of the two recessions and their recoveries, but with an overall downward trend. With the recession of 2001, the percentage decreased and then somewhat recovered, though it never reached its pre-recession level before falling again during the

<sup>7</sup> NCSL, “State Partisan Composition” (Apr. 11, 2018).

<sup>8</sup> Robert W. Reed, “Democrats, Republicans, and Taxes: Evidence That Political Parties Matter,” *J. of Pub. Econ.*, 725 (2006).

<sup>9</sup> Figure 2 includes data for only the 41 states with a full personal income tax.

Great Recession. It again recovered, but, as with the 2001 recession, not to its 2001 level. Between 2001 and 2017, personal income taxes as a percentage of personal income decreased from 2.85 percent to 2.71 percent. Since 2013 the percentage has been essentially flat, decreasing slightly from 2.77 percent in 2013 to 2.71 percent in 2017 — a pattern consistent with that of total state tax revenue during this period, as shown in Figure 1.

I focus on the change between 2001 and 2017. One can attribute the decrease in income tax revenue as a percentage of income to three factors: nondiscretionary changes in taxable income, changes in state income tax rates, and other discretionary changes in state income tax structures.

Consider first the nondiscretionary change in taxable income as compared to personal income. Because states generally conform in some way to the federal income tax structure, I use federal modified taxable income to reflect potential state taxable income. I divide modified taxable income by personal income to explore how the income tax base as a percentage of income changed over time. Between 2001 and 2015, federal modified taxable income as a percentage of personal income did not change appreciably.<sup>10</sup> This finding suggests that the decrease in state income tax revenue as a percentage of income between 2001 and 2017 is not a result of nondiscretionary changes in taxable income, but rather of state-legislated changes in tax rates and other features of state income taxes. Between 2001 and 2017, states made many small changes to their definitions of taxable income.<sup>11</sup> For example, in fiscal 2014 and fiscal 2015, some states expanded several partial exemptions and deductions for things like contributions to 529 college savings plans, military pay, medical expenses, and long-term capital gains. Of greater significance were changes to the treatment of retirement income, including Social Security income. Since 1964 several states have provided full or partial exemptions for retirement income.

Five states fully exempt private retirement benefits, and 19 others provide a partial exemption.<sup>12</sup> Changes since 2001 have largely centered on increasing the size of the allowable retirement exemptions. Retirement exemptions also increased because the relative size of retirement income has grown from 5.08 percent of household income in 2005 to 5.93 percent in 2016 — a 16.7 percent increase. Estimates from the Georgia Governor’s Office of Planning and Budget show the state’s retirement exemption reduced personal income tax revenue by 7.88 percent and total tax revenue by 4.2 percent in 2017.<sup>13</sup>

States have also increased tax credits. For example, in fiscal 2014 and fiscal 2015, some states added or expanded tax credits for hybrid cars, education scholarships, child care expenses, angel investment, property tax circuit breakers, and small businesses. One credit that many states have adopted and expanded is the earned income tax credit. In 1999, 11 states had an EITC, but by 2017,

<sup>10</sup> 2015 is the most recent year for which federal modified taxable income is available.

<sup>11</sup> Recent tax changes are available at NCSL, “State Tax Actions Database” (May 22, 2017).

<sup>12</sup> See NCSL, “Pension and Retirement Legislation Information by State” (Apr. 2, 2018).

<sup>13</sup> See Governor’s Office of Planning and Budget, Georgia Tax Expenditure Reports for Fiscal Years 2017-2019. Georgia offers a relatively generous retirement income deduction.

29 states offered this credit. For fiscal 2014 and fiscal 2015, Connecticut, Iowa, Maryland, Minnesota, Ohio, Oregon, and Rhode Island either added or expanded their EITC. While a few states made structural changes that increased income tax revenue, most of the definitional changes to taxable income and the tax credit increases reduced income tax revenues.

Between 2001 and 2017, 16 states reduced and 10 states increased their top marginal rates. However, from 2013 to 2017, 12 states reduced and only two states increased their top marginal tax rates. The tax rate changes in several states also resulted in a reduction in the elasticity of income tax revenue, meaning that an increase in income results in a smaller percentage increase in tax revenue. States that reduced their tax rates saw an average decrease in income tax revenue as a percentage of personal income of -0.16 percentage points during the period 2001 to 2017. Unsurprisingly, in general, the larger the tax rate cut, the larger the decrease in income tax revenue as a percentage of personal income.

The National Association of State Budget Officers reports that states in the aggregate made discretionary cuts to personal income taxes in every fiscal year from 2014 to 2017.<sup>14</sup> The aggregate increase in income tax revenue in 2013 was caused by tax increases in California and New York; excluding those two increases, total discretionary tax changes for the other states were negative.

The income tax revenue decrease as a percentage of income appears to stem from decisions to cut taxes. In other words, it was not that states failed to raise taxes sufficiently to maintain or increase income tax revenue as a percentage of income, but rather that states' discretionary reductions in state income taxes caused income taxes as a percentage of income to fall. Thus, the decrease in income tax revenue as a percentage of income from 2012 to 2017 is likely due to policy changes, perhaps with the intention of reducing income tax revenue as a percentage of income.

Should we expect income tax revenue as a percentage of personal income to remain flat, or will it likely return to the pre-2001 level? Evidence suggests that the trend will remain relatively flat.

First, calls for reducing or eliminating income taxes as well as for substituting consumption taxes (mainly sales taxes) for income taxes are on the rise. Several governors have called for such action, and recent tax reform commissions have made similar recommendations.<sup>15</sup> For example, tax reform studies in states including California, Hawaii, Oklahoma, Oregon, Indiana, and Georgia have considered or recommended eliminating the state's income tax, though to date none of these states has eliminated its income tax. It is unclear whether the calls for eliminating the income tax are just political rhetoric or are rooted in an idea with broad support that has yet to be adopted because of the difficulty making up lost revenue. However, the growing discourse suggests a desire to reduce income tax revenue. On the other hand, tax reform studies in three states — Tennessee, Washington, and Wyoming — recommended that lawmakers

<sup>14</sup> See various years from the National Association of State Budget Officers, "The Fiscal Survey of the States."

<sup>15</sup> Carolyn Bourdeaux, "A Review of State Tax Reform Efforts," *State Tax Notes*, Mar. 21, 2011, p. 859; Rahul Pathak et al., "State Tax Reform Efforts: 2010-2015," The Center for State and Local Finance (Jan. 26, 2016); and Jared Walczak, "Trends in State Tax Policy, 2018," *State Tax Notes*, Feb. 5, 2018, p. 577.

consider adding a state income tax. In response, in 2014, 66 percent of Tennessee voters approved a constitutional amendment prohibiting the state from imposing an income tax. In 2010, 64 percent of Washington voters voted no on a referendum that proposed to tax adjusted gross income above \$400,000 for married couples. In Wyoming, the governor rejected the idea out of hand.

Second, income inequality is rising, which is likely to increase pressure on states to adopt or expand EITCs. Similarly, the growth in the proportion of seniors among the population will increase the relative size of retirement income and will likely lead to increased political pressure to exempt more retirement income.

Finally, it is unclear what effect the Tax Cuts and Jobs Act (P.L. 115-97) will have on state income tax revenue. Depending on how states conform to federal taxes, they, in the absence of any adjustments, could experience an increase or decrease in state income tax revenue. The TCJA reduced federal marginal income tax rates and capped deductions for state and local taxes, which increased the net cost of state taxes for taxpayers who itemize. Economic theory suggests that these changes will put downward pressure on state tax rates, including the income tax.

## Sales Tax

In 2017 sales tax revenue accounted for 31.8 percent of total state tax revenue. Figure 3 shows that sales tax revenue as a percentage of income trended up between 1972 and 1995, with exceptions primarily in the years around the 1980 and the 1981-1982 recessions.<sup>16</sup> Since 1995, however, the trend has been on a downward trajectory. The pattern is associated with changes in sales tax rates as well as non-discretionary and discretionary changes in taxable expenditures relative to income.

Table 1 shows the distribution of state sales tax rates for four years: 1972, 1995, 2010, and 2017. Between 1972 and 1995, sales tax rates increased. In 1972, only seven of the 45 states with a sales tax had tax rates of 5 percent or higher; by 1995, that number had risen to 30. The average tax rate increased from 3.73 percent in 1972 to 5.16 percent in 1995 — an increase of 38.3 percent. Since 1995 there have been fewer increases in sales tax rates; for example, between 1995 and 2017 only five states increased their sales tax rate to 5 percent or higher. As a result, the increase in the average tax rate between 2010 and 2017 was small, from 5.56 percent to 5.67 percent — an increase of 2 percent.

To measure the effect of non-discretionary changes to the sales tax base, I focus on Alabama sales tax revenue data. Alabama had a 4 percent sales tax rate between 1972 and 2017 and reportedly has made few legislative changes to its tax base. For example, it is one of the few states that has not adopted an exemption for food for home consumption. Thus, one can use these data as a proxy for changes in the sales tax base. Sales tax revenue as a percentage of income in Alabama fell continually between 1972 and 2017 (Figure 4) — a decrease of 32.5 percent over the period. For sales tax revenue as a percentage of

<sup>16</sup> Figure 3 includes data for only the 45 states with a state sales tax.

income in 2017 to equal the value in 2001, Alabama would have to increase its sales tax rate to 5.9 percent.

The principal cause of the non-discretionary decrease in sales tax revenue as a percentage of income is that services, which are mostly exempt from sales taxes, have increased from 51.4 percent of total personal consumption expenditures in 1972 to 67.9 percent in 2017.<sup>17</sup> Thus, the sales tax is being applied to a smaller share of consumer purchases.<sup>18</sup> A second explanation is the rise in remote sales, on which states have had a hard time collecting taxes. The Government Accountability Office estimates that the states are losing between \$8.5 and \$13.4 billion in revenue each year due to their inability to collect taxes on remote sales.<sup>19</sup>

States have also made discretionary changes to their sales tax bases. Perhaps the single largest exemption that some states have adopted is for purchases of food for home consumption. In 1972, 15 states exempted such expenditures; by 2017, 33 states had this exemption. In general, the exemption is substantial — for example, it reduces sales tax revenue in Georgia by an estimated 10 percent.<sup>20</sup>

States have also added many exemptions for business purchases, including consumables used in agricultural and industrial machinery and equipment and energy used in production. Some services have been added to sales tax bases, but for most states this has not resulted in a substantial revenue increase. Estimates of the value of the discretionary changes to sales tax bases are unavailable.<sup>21</sup>

Between 1972 and 1995, sales tax revenue as a percentage of income increased while the sales tax base as a percentage of income fell. The implication is that the decrease in the sales tax base (Figure 4) was more than offset by the increase in sales tax rates (Table 1), resulting in the increase in sales tax revenue as a percentage of income shown in Figure 3. However, from 1995 to 2017, national sales tax revenue as a percentage of income decreased (Figure 3), as did the sales tax base as a percentage of income (Figure 4). The implication is that increases in sales tax rates were insufficient to offset the decreases in the sales tax base as a percentage of income.

The recent decrease in sales tax revenue as a percentage of income is likely due in part to an increasing unwillingness by states to raise sales tax rates in the face of non-discretionary reductions in their sales tax base as a percentage of income. Simultaneously, states have narrowed the range of goods and services

<sup>17</sup> Bureau of Economic Analysis, “National Income and Product Accounts, Table 2.3.5U, Personal Consumption Expenditures by Major Type of Product and by Major Function.”

<sup>18</sup> John L. Mikesell, “The Disappearing Retail Sales Tax,” *State Tax Notes*, Mar. 5, 2012, p. 777. Mikesell regards the absence of services in the tax base as the primary cause of the downward trend in the state sales tax base relative to personal income.

<sup>19</sup> U.S. Government Accountability Office, “Sales Taxes,” GAO-18-114 (2017).

<sup>20</sup> Laura A. Wheeler and David L. Sjoquist, “Estimating the Revenue Loss From Food-for-Home Consumption,” Andrew Young School of Policy Studies, Georgia State University Fiscal Research Center (Jan.2011).

<sup>21</sup> Robert D. Buschman, “Georgia’s Incredible Shrinking Sales Tax Base,” Fiscal Research Center, Oct. 6, 2015. Buschman has estimated the effect of sales tax base exemptions between 2001 and 2014 for Georgia.

subject to sales tax. And despite calls for increasing the sales tax base, states have not done so. Thus, one might conclude that the recent trend shown in Figure 3 is likely the result of policy choices.

There are several reasons to believe that, in the absence of tax rate increases, state sales tax revenue as a percentage of income will continue to decline. The percentage of income spent on services is likely to continue expanding, while adding services to the tax base faces several barriers. First, political support for adding services seems low, as illustrated by Florida's failed experiment of adding services in 1987<sup>22</sup> and Maine voters repealing the 2009 addition of 100 goods and services to its sales tax base.<sup>23</sup> Second, as reported by the Bureau of Economic Analysis, housing services, healthcare, education, insurance, and social services/religion account for 57.5 percent of services, all of which it is hard to imagine states taxing. Third, states face administrative difficulties in taxing services given that many service providers are sole proprietors, making registering providers and monitoring tax collection a challenge.

The recent Supreme Court decision in *Wayfair*<sup>24</sup> will require remote vendors to collect sales taxes, though it is unclear how much additional sales tax revenue states will collect. One study estimates that only about 57.3 percent of retail e-commerce will be subject to sales taxes given the probable magnitude of small-seller exemptions and that nearly 50 percent of e-commerce sales are already taxed.<sup>25</sup> Further, many states are proposing to use any additional revenue from sales taxes collected on e-commerce to cut taxes.<sup>26</sup>

States have shown a recent unwillingness to increase sales tax rates. Some states have discussed increasing sales taxes as a replacement for income taxes but have not done so. There is nothing to suggest that this unwillingness to raise sales tax rates is temporary. Thus, it seems unlikely that sales tax revenue as a percentage of income will increase much in coming years.

## Corporate Income Tax

In 2017, state corporate income tax revenue accounted for 4.7 percent of total state tax revenue — a decrease from 7.4 percent in 1972. As seen in Figure 5, state corporate income tax revenue as a percentage of income increased between 1972 and 1979 but has since followed a sawtooth pattern with a general downward trend. Between 1979 and 2017, corporate income tax revenue as a percentage of income decreased by 54.3 percent.

<sup>22</sup> Walter Hellerstein, "Florida's Sales Tax on Services," *Nat'l Tax J.*, 1988, 1.

<sup>23</sup> See Maine Tax Code People's Veto, Question 1 (June 2010).

<sup>24</sup> 585 U.S. \_\_\_\_ (2018).

<sup>25</sup> Donald Bruce and William F. Fox, "An Analysis of Internet Sales Taxation and the Small Seller Exemption," Center for Business and Economic Research, University of Tennessee (2013).

<sup>26</sup> David A. Lieb, "Republicans Propose Using Sales Tax Money for New Tax Cuts," *U.S. News & World Report*, June 29, 2018.

Researchers have suggested several explanations for this trend, including reduced tax rates, a shift in organizational form, more aggressive tax planning, and increases in the number and size of tax credits.<sup>27</sup> State corporate tax rates increased on average between 1972 and 2002, but 12 states have reduced their rates since 2002, with most of the reductions exceeding 1 percentage point. Only six states have increased their corporate income tax rates, generally by modest amounts.

A reduction in tax rates explains some of the recent drop in corporate income tax revenue as a percentage of income, but changes in the tax base — both nondiscretionary and discretionary — have also contributed to the downward trend. First, as firms shifted their organizational form to S corporations and limited liability companies, the number of C corporations has decreased substantially, from nearly 2.6 million in 1986 to 1.61 million in 2013 — a 38 percent decrease. Second, states have begun offering more economic development tax credits. One study found that a total of 147 job creation programs were added in 45 states between 1969 and 2012.<sup>28</sup> In 1992 Louisiana became the first state to adopt a film industry income tax credit, and now 31 states offer film production incentives.<sup>29</sup> Researchers have found that tax incentives are a major factor in the decline of state corporate income taxes.<sup>30</sup> Third, corporations have engaged in more aggressive tax planning, such as reclassifying business income as nonbusiness income and establishing passive investment companies.<sup>31</sup>

Recent developments suggest that corporate income tax revenue as a share of income is likely to continue decreasing. First, tax reform commissions in states including California, Hawaii, Oregon, and Utah have proposed reducing or eliminating their corporate income tax, as Ohio has done. Second, the increased geographic mobility of capital and interstate competition for jobs will likely drive states to reduce their taxes on mobile capital by dropping corporate income tax rates and adopting more and expanded development-related tax credits. Third, tax experts are expressing declining support for the state corporate income tax. For example, Kirk J. Stark is convinced that changes to state corporate income taxes have made the tax untenable.<sup>32</sup> David Brunori has said he believes it is impossible to fix the problems with the state corporate income tax, and that states should drop it.<sup>33</sup>

It would be incorrect to ascribe the entire decrease in corporate income tax revenue as a percentage of income to policy decisions. Clearly, however, states are unlikely to change their corporate income taxes so that tax revenue as a percentage of income will return to pre-2001 levels.

<sup>27</sup> Gary C. Cornia et al. “The Disappearing State Corporate Income Tax,” *Nat’l Tax J.*, 115 (2005); and Fox and LeAnn Luna, “State Corporate Tax Revenue Trends: Causes and Possible Solutions,” *Nat’l Tax J.*, 491 (2002).

<sup>28</sup> David Neumark and Diego Grijalva, “The Employment Effects of State Hiring Credits,” *ILR Review*, 1111 (Dec. 27, 2016).

<sup>29</sup> NCSL, “State Film Production Incentives and Programs” (Feb. 5, 2018).

<sup>30</sup> Peter Fisher, “Tax Incentives and the Disappearing State Corporate Income Tax,” *State Tax Notes*, Mar. 4, 2002, p. 767.

<sup>31</sup> See Richard Pomp, “The Future of the State Corporate Income Tax: Reflections (and Confessions) of a Tax Lawyer,” *State Tax Notes*, Mar. 22, 1999, p. 939; David Brunori, “The Future of State Taxation,” Urban Institute Press (July 1, 1998); and Luna, “Corporate Tax Avoidance Strategies and States’ Efforts to Prevent Abuses,” *J. of Multistate Taxation and Incentives*, 6-17, 46-48 (2004).

<sup>32</sup> Kirk J. Stark, “The Quiet Revolution in U.S. Subnational Corporate Income Taxation,” *State Tax Notes*, Mar. 4, 2002, p. 775.

<sup>33</sup> Brunori, “Stop Taxing Corporate Income,” *State Tax Notes*, July 1, 2002, p. 47.

## Fuel Tax

Motor fuel taxes account for 4.8 percent of total state tax revenue — a decrease from 7.2 percent in 1972. Except for a small increase between 1983 and 1993, motor fuel taxes as a percentage of income fell between 1972 and 2017 (Figure 6). This downward trend can be attributed to the decline in the quantity of gasoline consumed per dollar of income and the decrease in state fuel tax rates in real terms. Between 1993 and 2017, gasoline consumption per dollar of income fell 57.2 percent, and the average excise tax rate in real terms fell 19.9 percent. This explains the 34.1 percent decline in fuel tax revenue as a percentage of income between 1993 and 2017.

Gasoline consumption has been affected by rising gasoline prices and improved fuel efficiency. In 1970, cars got an average of 13 miles per gallon, compared with 30 miles per gallon in 2017, and fuel efficiency is expected to continue to improve. Federal standards call for fuel efficiency to increase to 54.5 miles per gallon by 2025. There does not seem to be political support for significant increases to motor fuel excise tax rates. In fact, states have not raised their fuel excise tax rates sufficiently to maintain real fuel tax revenue per capita, much less per dollar of income. Thus, fuel tax revenue as a share of income will likely continue to decrease.



## Summary

Total state tax revenue as a percentage of personal income in the nine years since the Great Recession has been significantly lower than from

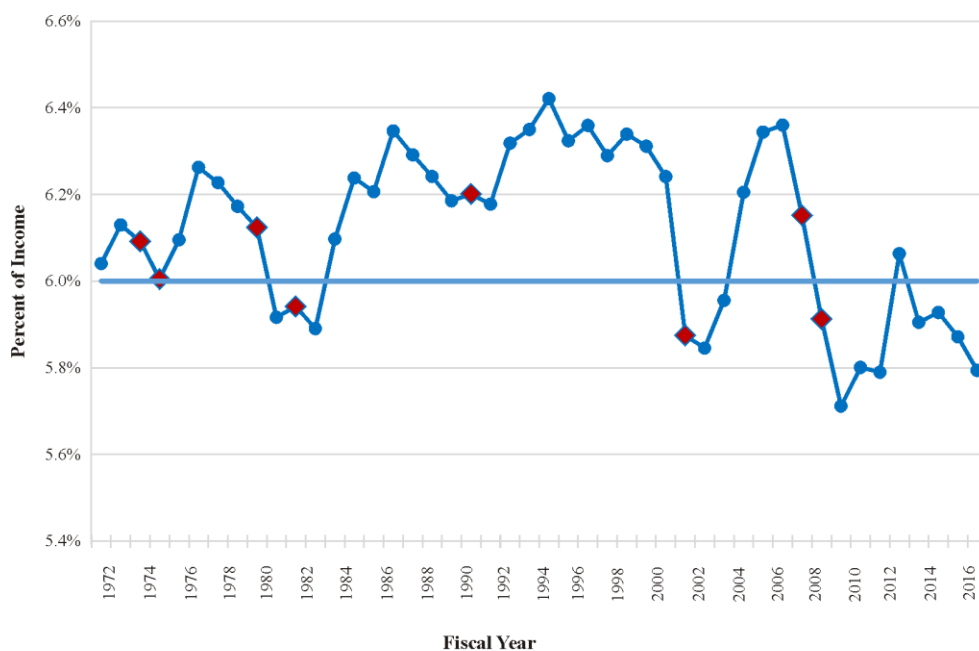
1972 to 2008. This paper explored possible explanations for this trend. For some taxes, including the sales tax, states have made significant non-discretionary changes to the tax base relative to income. Although such changes are not new phenomena, states maintained higher percentages of tax revenue relative to personal income during the pre-Great Recession period. Thus, the lower level of state tax revenue as a percentage of income post-Great Recession is likely the result of policy decisions. Consequently, this lower level of state taxes as a percentage of income seems to be a new normal. There are several potential explanations for this change:

- Voters could prefer lower state expenditures. However, that raises the question of why demand for public services has fallen.
- Increased economic competition among states for new businesses may have driven them to set policies that led state taxes as a percentage of income to drop.
- The economic decline caused by the Great Recession may have led states to keep taxes lower to spur economic recovery.
- This trend could be driven by the shift in political parties that control state governments. This could reflect changes in voter preferences for state expenditures. Alternatively, the change in political control may be driven by policy issues other than tax levels, and Republicans may have used this power to lower taxes as a percentage of income.
- This new normal could be some sort of hangover from the Great Recession. For example, most states increased taxes during the recession, in some cases significantly, making it potentially difficult to adopt additional increases.

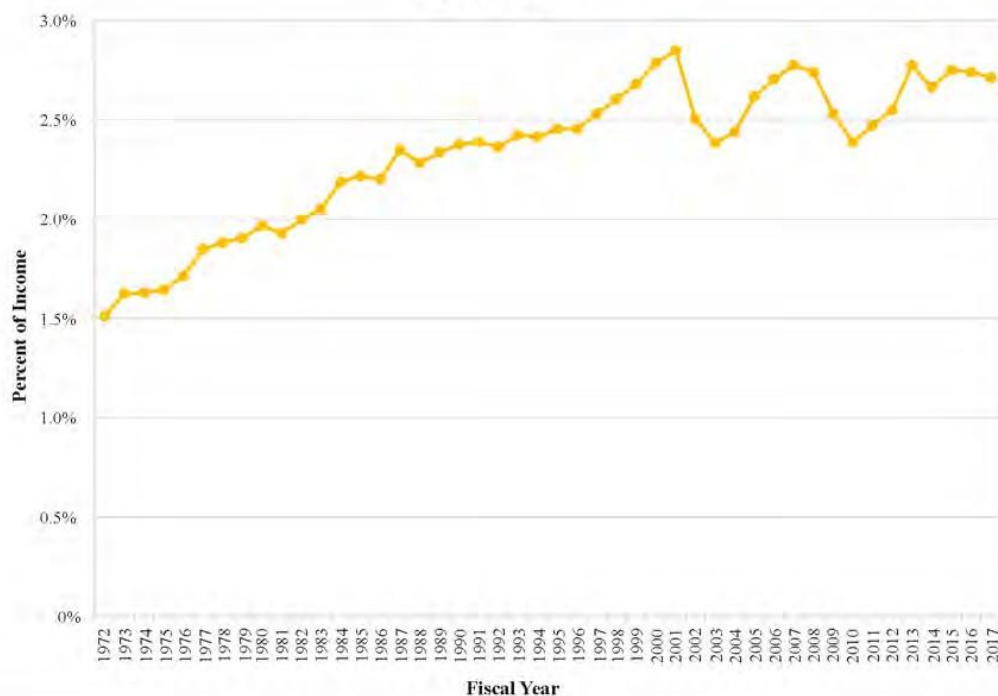
Is this new normal a temporary or more long- term condition? That depends on the reason for the trend, which is unknown. I will not venture a guess. But time will tell, so we anxiously await the fiscal 2018 tax data to see if the trend continues.

## Appendix

**Figure 1. Total State Taxes,  
1972-2017**



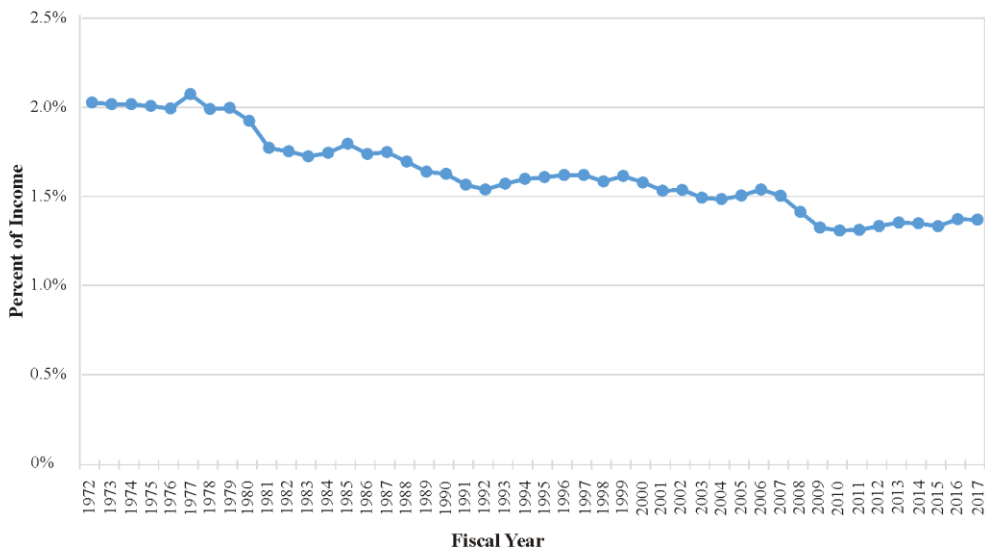
**Figure 2. Personal Income Tax,  
1972-2017**



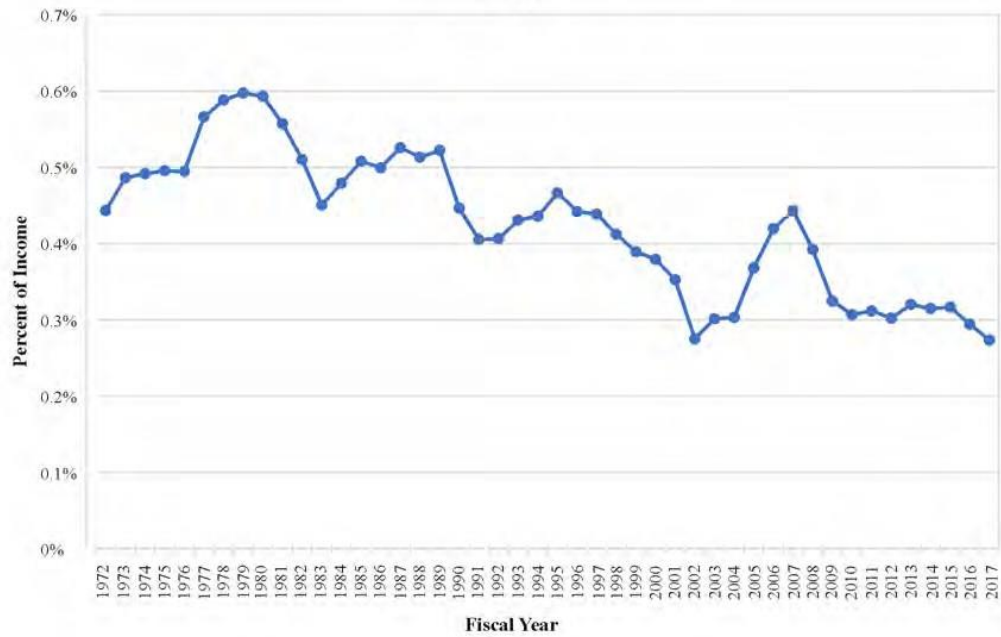
**Figure 3. General Sales Tax,  
1972-2017**



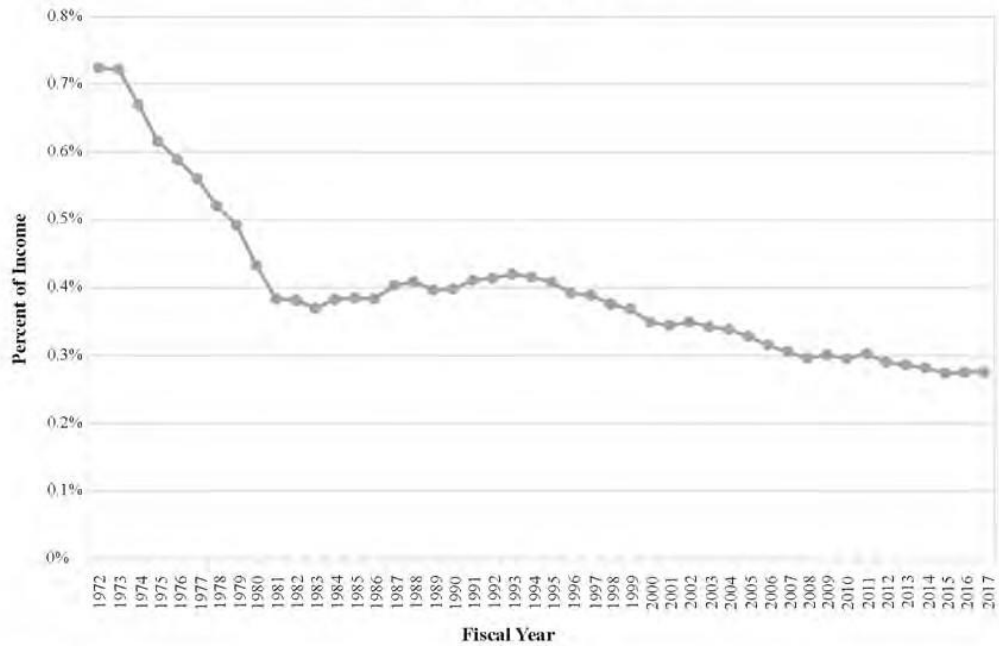
**Figure 4. Sales Tax Revenue, Alabama,  
1972-2017**



**Figure 5. Corporate Income Tax,  
1972-2017**



**Figure 6. Fuel Tax Revenue,  
1972-2017**



**Table 1. Distribution of Sales Tax Rates**

	YEAR			
	1972	1995	2010	2017
2%-2.9%	3	0	1	1
3%-3.9%	18	2	0	0
4%-4.9%	17	13	10	9
5%-5.9%	5	13	10	10
6%-6.9%	2	15	18	20
7%-7.9%	0	2	6	5
<b>Average</b>	<b>3.73%</b>	<b>5.16%</b>	<b>5.56%</b>	<b>5.67%</b>
Source: John F. Due and John L. Mikesell. 1994. <i>Sales Taxation: State and Local Structure and Administration</i> (2nd ed.). Washington, D.C.: Urban Institute Press. All States Tax Handbook, 1996, New York, NY: Research Institute of America; and Urban Institute/Brookings Institution Tax Policy Center. Data do not include the District of Columbia.				

## About the Author

---

**David L. Sjoquist** is a faculty member in the Andrew Young School of Policy Studies at Georgia State University. A specialist in the field of public finance, Sjoquist has an extensive interest in urban economics, especially local economic development, central city poverty, and education policy. He has published extensively on topics, such as analysis of public policies, tax allocation districts, teenage employment, local government fiscal conditions, and the urban underclass. His current research interests include property taxation, school financing, local sales taxes and income taxes. His work has been published in such journals as *American Economic Review*, *Journal of Public Economics*, *National Tax Journal*, and *Review of Economics and Statistics*. He holds a doctorate from the University of Minnesota.

---